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Supreme Court of the United States

OCTOBER TERM, 1941.

No. 896.

FAITOUTE IRON & STEEL COMPANY, THE HOWARD SAVINGS INSTITUTION, FLORENCE W. FAITOUTE, *et als.*,

Appellants,

vs.

CITY OF ASBURY PARK, a Municipal Corporation of the State of New Jersey,

Appellee.

ON APPEAL FROM THE COURT OF ERRORS AND APPEALS OF NEW JERSEY.

REPLY BRIEF OF APPELLANTS.

ARTHUR T. VANDERBILT,
Attorney of Appellants.

On the Brief:
G. DIXON SPEAKMAN,
H. ALLEN LOCHNER.

Newark, N. J.,
April, 1942.

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FEDERAL CONSTITUTION.

Article I, Section 10 2

NEW JERSEY STATUTES.

Revised Statutes, Title 52, Chapter 27 2

Revised Statutes, Title 52, Chapter 27, Article 7 2

R. S. 52:27-32.1 and 33 2

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ON APPEAL FROM THE COURT OF ERRORS AND APPEALS OF NEW JERSEY.

REPLY BRIEF FOR APPELLANTS.

I.

Reply to Point I of Appellee's Brief.

In Point I of its brief, the appellee attempts to sustain the constitutionality of the compulsory composition statute here involved, construed so as to apply to pre-existing municipal obligations, on the ground that it was a valid exercise of the police power of the state and, as such, did not impair the obligation of contracts in violation of

Article I, Section 10, of the Constitution of the United States.

The complete fallacy of appellee's position has been demonstrated in appellants' original brief. In the main, therefore, it will suffice to point out the inapplicability of the cases cited by appellee in Point I of his brief.

Initially, note should be taken of the fact that appellee's title heading under Point I tends to confuse an otherwise clear issue. According to the title, appellee purports to contend that not only Article 7 of Chapter 27 of Title 52 of the Revised Statutes, the compulsory composition provisions, but Chapter 27 of Title 52 in its entirety is constitutional. No issues are raised in the present case as to the constitutionality of any portion of Chapter 27 other than Article 7 thereof.

Apparently, it is appellee's confusion in this matter, that has led him to rely on *Hourigan* v. *North Bergen Township,* 113 N. J. L. 143 (E. & A. 1934). While that case, in any event, could not constitute a binding authority in this Court, it will perhaps be permissible to show its inapplicability to the issues now in suit.

In the *Hourigan* case, the Court of Errors and Appeals of New Jersey, by a seven to six vote, upheld the constitutionality of the stay provisions of the Municipal Finance Act, R. S. 52:27-32.1 and 33. R. S. 52:27-32.1 provides that the enforcement of judgments against municipalities on their obligations shall be stayed so long as the Municipal Finance Commission shall function therein unless consent to such enforcement is obtained from the New Jersey Supreme Court or a justice thereof. R. S. 52:27-33 provides that, so long as the Commission shall function therein, no proceeding may be brought to compel a municipality to assess, levy or collect taxes, except that the New Jersey

Supreme Court or a justice thereof, may authorize one or more creditors, suing on behalf of all other creditors, to bring such an action. The Court held that these stay provisions were constitutional as emergency measures under the police power of the state to permit financially embarrassed municipalities to continue to perform essential governmental functions.

Appellee is apparently under the impression that the Court of Errors and Appeals passed upon the constitutionality of the composition statute here in question in the *Hourigan* case. A reading of the Court's opinion clearly demonstrates that this is not so, for the composition statute is nowhere mentioned or referred to. The sole issue before the Court was the validity of the stay provisions above referred to and Mr. Justice Heher pointed out in the opinion (113 N. J. L. 143, at 148) that those were the sections to be passed upon. Since the case did not in any way involve a refunding plan, it is impossible that the provisions of the composition statute were at issue. Indeed, the opinion of the Supreme Court in the *Hourigan* case (11 N. J. Misc. R. 194) shows that the matter was argued before it on October 5, 1932, many months before the enactment of the composition statute, which became law on June 27, 1933 (P. L. 1933, c. 331, p. 866). It is obvious, therefore, that the appellee cannot rely on the *Hourigan* case as declaring the constitutionality of the composition provisions.

The *Hourigan* case is in no way an authority in support of the constitutionality of the composition statute. The stay provisions there sustained did not deprive creditors of their rights forever; they were limited in duration to the period when the Municipal Finance Commission was operating in the community and a substituted remedy was given during that time. The Court clearly regarded the statutes there upheld as merely imposing a temporary

stay while the Commission performed its functions in the municipality, similar to those of a receiver of an insolvent corporation. Great reliance was placed upon the then recent case of *Home Building & Loan Association* v. *Blaisdell*, 290 U. S. 398 (1934) and the doctrine of emergency powers there set forth and it is clear that the Court deemed that the challenged statutes were a reasonable exercise of those powers since they provided a temporary rather than a permanent restraint.

Nothing in the *Hourigan* case, therefore, can be taken as in the slightest degree approving the constitutionality of the compulsory composition act here involved. The stays therein sustained as reasonable emergency measures were limited in duration to the emergency giving rise thereto and former rights were revested at the end of the period of emergency. There are obvious differences between those statutes and the act here in question which seeks to wipe out pre-existing rights forever.

Though the *Hourigan* case is manifestly inapplicable, it might be noted that even as to the proposition for which it stands—the constitutionality of the stay provisions—the decision is contrary to authority. In *Borough of Fort Lee* v. *United States*, 104 F. (2d) 275 (C. C. A. 3rd, 1939), the Court of Appeals for the Third Circuit unanimously held that the *same* stay provisions violated the obligation of contracts and were therefore void. A similar decision was made in *Sovereign Camp W. O. W.* v. *Wilentz*, 23 F. Supp. 23 (D. C. N. J., 1938), *appeal dismissed*, 306 U. S. 573 (1939). And in the case of *Waterville Realty Corp.* v. *City of Eastport*, 136 Me. 309 (1939), the Supreme Judicial Court of Maine held unconstitutional the same type of stay provisions as were sustained in the *Hourigan* case, finding that they were not reasonable emergency measures and therefore impaired the obligation of contracts.

Appellee, in Point I of his brief, also relies on *Home Building & Loan Association* v. *Blaisdell*, 290 U. S. 398 (1934). Appellants have fully discussed the *Blaisdell* case at page 30 *et seq.* of their original brief. Further comment is unnecessary other than to reiterate that not only does the *Blaisdell* case fail to support the appellee's contentions, but it conclusively demonstrates the unconstitutionality of the composition statute as applied to pre-existing obligations.

Block v. *Hirsh*, 256 U. S. 135 (1921), cited by appellee under Point I, is obviously not in point. The case involved the unsual situation created by the housing shortage in the District of Columbia during the first World War. To remedy the condition, a statute was passed giving tenants the right to continue to occupy rental properties after the expiration of their terms, subject to regulation by a commission, so long as such tenants paid their rents and performed the conditions of their leases. The statute recited the emergency created by the war, and declared that the statute would terminate in two years unless sooner repealed. The extreme situation, it was held, clothed the rental of buildings in the District with a public interest which justified a temporary control by proper regulation. Obviously, the facts of the *Block* case are so at variance with those of the instant case that even a comparison of the cases is precluded.

Equally beside the point are the Gold Clause cases, *Norman* v. *B. & O. R. Co.*, 294 U. S. 240 (1935); *Nortz* v. *United States*, 294 U. S. 317 (1935); and *Perry* v. *United States*, 294 U. S. 330 (1935).

In the *Norman* case the validity of a Joint Resolution of Congress nullifying the provisions in private contracts purporting to give the obligee a right to require payment in gold or a particular kind of coin or currency was founded

on the constitutional power of Congress to regulate the value of money. Conceding the existence of that power, it was obvious that provisions of private contracts could not interfere with the exercise of that power. It is a far cry from such a ruling to the instant case, where a state enactment, instead of being supported by a constitutional sanction, is confronted by an express constitutional prohibition of such enactment.

In *Nortz* v. *United States, supra,* the plaintiff was the owner of gold certificates of the nominal amount of $106,300. He brought suit alleging that the United States had certified that $106,300 in gold coin would be paid to him on demand; that at the time of issuance a dollar in gold consisted of 25.8 grains, .9 fine; that on January 17, 1934 he presented the certificates; that on that date an ounce of gold was worth $33.43 and he was therefore entitled to receive in redemption $170,634.07; that because of the order of January 15, 1934 requiring all persons to pay over to the United States gold certificates owned by them in return for an equivalent amount of other coin or currency, plaintiff delivered the certificates under protest, and received currency in the sum of $106,300 and not redeemable in gold. It was held for defendant on the ground that plaintiff had received all to which he was entitled and could therefore show no damages, since after the order of January 15, 1934 there was no market for gold or gold certificates. Clearly, the case has no bearing whatever on the issues here involved.

Of the same nature was *Perry* v. *United States, supra.* There, the Joint Resolution of June 5, 1933 was again under attack by an owner of a United States bond, issued in 1918, providing that it was payable in "United States gold coin of the present standard of value." Though plaintiff was denied recovery on the ground that he could

show no damages since Congress had withdrawn gold and gold certificates from circulation, the Resolution was declared unconstitutional as applied to government bonds. The Court refused to sanction a repudiation of the public obligation. Though the case is not in point, it suggests the parallel in the present case where, in effect, a repudiation of a public debt has been attempted.

In *Hudson Water Co.* v. *McCarter*, 209 U. S. 349 (1908), cited by appellee in Point I, the defendant had contracted to furnish water, taken from the Passaic River in New Jersey, to municipalities in New York. The State of New Jersey, reciting the need for preserving fresh water for the health of its citizens, then enacted that it should be unlawful to carry water of New Jersey streams into any other state. The defendant was enjoined from so doing by the New Jersey courts on the ground that he was a riparian proprietor and as such had no right to divert waters for more than a reasonable distance and for other than ordinary uses. The residuum of public ownership in the waters was also relied upon. This Court, in affirming, did not disagree with the reasons advanced by the courts below but preferred to rest its decision on the broader ground that the state has a particular interest in protecting its waters in substantially undiminished form and that private contracts cannot interfere with this paramount interest. The contract, in the Court's view, was illegal when made. This is indicated by the sentence from the opinion directly following the quotation given in the appellee's brief. Thus, the Court states (209 U. S. at p. 357):

> "The defense under the Fourteenth Amendment is disposed of by what we have said. That under Article I, §10, needs but a few words more. One whose rights, such as they are, are subject to state restrictions, cannot remove them from the power of

> the State by making a contract about them. The contract will carry with it the infirmity of the subject matter.' *Knoxville Water Co.* v. *Knoxville*, 189 U. S. 434, 438; *Manigault* v. *Springs*, 199 U. S. 473, 480. *But the contract, the execution of which is sought to be prevented here, was illegal when it was made"* (italics ours).

Nothing further need be said to distinguish the *McCarter* case.

A considerable portion of Point I of appellee's brief is devoted to a discussion of cases involving building and loan association legislation. The cases cited are *Bucsi* v. *Longworth B. & L. Assn.*, 119 N. J. L. 120 (E. & A. 1937); *Veix* v. *Sixth Ward Bldg. & Loan Asso. of Newark;* 123 N. J. L. 356 (E. & A. 1939), *aff'd.*, 310 U. S. 32 (1940); and *Veix* v. *Seneca Building and Loan Assn.*, 126 N. J. L. 314 (E. & A. 1941).

The cases may be disposed of as a group. All involved the endeavors of shareholders of building and loan associations to withdraw and be reimbursed for their shares in the order in which notice of withdrawal was given, as they were permitted to do by legislation in effect when they became members, in the face of subsequent legislation which established priority of payment to holders of matured shares, and which required shareholders to accept pro rata payment regardless of the order of the withdrawal notices when ample funds were not at hand. The legislation was upheld, the courts recognizing the fact that building and loan associations are businesses of a special nature, peculiarly subject to legislative regulation. Such associations have always been regulated in minute detail under the police power, and contracts made in connection therewith must be deemed subject to such control. As Mr. Justice Reed succinctly

phrased it in *Veix v. Sixth Ward Bldg. & Loan Asso. of Newark, supra,* (310 U.S. at p. 38):

> "It was while statutory requirements were in effect that petitioner purchased his shares. When he purchased into an enterprise already regulated in the particular to which he now objects, he purchased subject to further legislation upon the same topic."

In other words, withdrawal rights in building and loan associations, having always been governed by statute, are subject to change by the legislature under its police power. The courts have pointed out that this power to change is analogous to the reserved power to amend corporate charters and that shareholders acquired their shares subject to the power to change the existing law. The composition statute here involved cannot be sustained on this theory. The rights of which appellants have been deprived are rights given by the express terms of the contract and not by statute. The amount and time of payment as agreed upon have been changed and all remedy to enforce the contract is denied. It is clear that there is no reserved power to make such changes in appellants' contracts. Manifestly, therefore, an altogether different set of principles are applicable to building and loan associations than are applicable to compulsory composition statutes. The latter principles are to be sought in the cases involving composition statutes and not in building and loan law.

Further, the legislation sustained in the building and loan cases merely provided for a change in the statutory method of enforcing withdrawal rights and did not have the effect of repudiating the contract of the shareholder. The law merely provided for a stay in the enforcement of these rights and the stay, being directly dependent for its duration upon the financial status of the association, was

limited to the emergency giving rise to the statute. There was no change in the amount to be paid to the shareholders and no variation of the terms of the obligation as entered into between the parties. In *Rocker* v. *Cardinal Building & Loan Assn.*, 13 N. J. Misc. 397 (Sup. 1935), *aff'd.*, 119 N. J. L. 134 (E. & A. 1937), the Court specifically so stated (13 N. J. Misc. at p. 403):

> "'The 1932 amendment of section 52 (the subsequent legislation involved in the building and loan cases) does not reduce the amount of plaintiff's monetary interest in the defendant association. It is true that it provides a different scheme for the payment of withdrawals than that provided by the section which it amends, but the statutory changes merely related to the *time*, and not the *quantum*, of payment" (Italics ours).

In *Gelfert* v. *National City Bank*, 313 U. S. 221 (1941), cited under Point I of appellee's brief, this Court, reversing a decision of the New York Court of Appeals, held that a New York statute, applicable generally and not limited to any declared public emergency, which provides in substance that in determining the amount of a deficiency judgment on the foreclosure of a mortgage, the court shall fix the "fair and reasonable market value" of the property and shall deduct from the amount of the debt either such market value or the sales price of the property, whichever is the higher, is not, at least in a case where the mortgagee purchases the property at the sale, an unconstitutional impairment of contract obligations in violation of the Federal Constitution, as applied to a mortgage executed before the enactment of the statute.

The *Gelfert* case is in no way contrary to appellants' position. As in the building and loan cases, so there, the statute did not alter the terms of the contract entered into

between the parties. It merely changed the procedure to be followed in foreclosing mortgages, a matter already governed by statutory enactment. The Court pointed out in its opinion that courts of equity and legislatures have long exercised control over judicial sales to prevent discrimination. Although the Court held that it was not essential to the validity of the statute that it be addressed to a declared public emergency, it recognized that the statute was directed to the emergency caused by economic depression and that it was reasonably adapted to that end, operating to upset the actual sales price as the factor in determining the amount of deficiency only when real estate values were so depressed as to render the price realized at public sale an inadequate test of value actually received by a mortgagee who buys in. The statute was sustained, not on the ground that there was a justifiable deprivation of a contract right, but rather on the theory that a mortgagee receives payment in full thereunder and has no contract right to a double satisfaction of his debt.

Mr. Justice Douglas, writing for the Court, said (313 U. S. at p. 232):

> "We mention these matters here because they indicate that for about two centuries there has been a rather continuous effort, either through general rule or by appeal to the chancellor in specific cases, to prevent the machinery of judicial sales from becoming an instrument of oppression. . . ."

Continuing (313 U. S. at p. 233):

> "Underlying that change has been the realization that the price which properly commands at a forced sale may be hardly even a rough measure of its value. The paralysis of real estate markets during periods of depression, the wide discrepancy between the

money value of property to the mortgagee and the cash price which that property would receive at a forced sale, the fact that the price realized at such a sale may be a far cry from the price at which the property would be sold to a willing buyer by a willing seller, reflect the considerations which have motivated departures from the theory that competitive bidding in this field amply protects the debtor.

"*Mortgagees are constitutionally entitled to no more than payment in full. Honeyman* v. *Jacobs, supra.* They cannot be heard to complain on constitutional grounds if the legislature takes steps to see to it that they get no more than that. As we have seen, equity will intervene in individual cases where it is palpably apparent that gross unfairness is imminent. That is the law of New York. 284 N. Y. 13, 20; 29 N. E. (2d) 449. And see *Fisher* v. *Hersey*, 78 N. Y. 387. But there is no constitutional reason why in lieu of the more restricted control by a court of equity the legislature cannot substitute a uniform comprehensive rule designed to reduce or to avoid, in the run of cases, the chance that the mortgagee will be paid more than once. Cf. *Suring State Bank* v. *Giese*, 210 Wis. 489; 246 N. W. 556. *Certainly under this statute it cannot be said that more than that was attempted.*" * * *

And (313 U. S. at p. 234):

> "*To hold that mortgagees are entitled under the contract clause to retain the advantages of a forced sale would be to dignify into a constitutionally protected property right their chance to get more than the amount of their contracts. Honeyman* v. *Jacobs, supra. The contract clause does not protect such a strategical, procedural advantage.*" (Italics ours.)

The conclusion follows, therefore, that the *Gelfert* case may not be relied upon to sustain the composition statute

here involved. The composition statute does not merely change the statutory procedure to be followed in enforcing contract rights, nor does it seek to limit appellants to a recovery of that to which their contracts actually entitle them. It alters the very terms of the obligations entered into between the parties, changing both the amount and time of payment, and permanently deprives appellants of all remedy to enforce their contracts.

II.

Reply to Appellee's Conclusion.

Appellee in his conclusion claims that the United States District Court did not pass on the constitutionality of the legislation under discussion in *Sovereign Camp, W. O. W.* v. *Wilentz*, 23 F. Supp. 23 (D. C. N. J. 1938), *appeal dismissed*, 306 U. S. 573 (1939). Reference to the case itself should suffice to establish that the case fully supports the proposition for which appellants cited it, namely, that the stay provisions of the New Jersey Municipal Finance Commission Act were there declared unconstitutional.

Nothing in the record supports the predictions of the appellee as to the results which would follow from a judgment for appellants in this case. It is beyond question of doubt that bondholders who have consented to the refunding plan involved in the present case cannot now question the validity of the new bonds or of the refunding plan in any way. *Shepherd* v. *Mount Vernon Trust Co.*, 269 N. Y. 234 (1935); *In re City of West Palm Beach, Fla.*, 96 F. (2d) 85 (C. C. A. 5th, 1938).

Appellants, therefore, again respectfully submit that the judgment of the Court of Errors and Appeals of New Jersey, affirming the judgment of the Supreme Court of New Jersey dismissing the appellants' complaint, should be reversed.

Respectfully submitted,

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